# Before the FEDERAL COMMUNICATIONS COMMISSION Washington, D.C. 20554

In the Matter of the	)	
The Federal-State Joint Board	)	
On Universal Service	)	CC Docket No. 96-45
	)	

# REPLY COMMENTS OF SUREWEST COMMUNICATIONS ON RECOMMENDED DECISION

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#### **SUMMARY**

SureWest Communications, and its wholly-owned ILEC subsidiary Roseville Telephone Company ("RTC"), show that there is substantial evidence in the record that the proposals in the Recommended Decision ("RD") are based on prohibited implicit subsidies, and are otherwise flawed policies. In addressing these flaws, the Commission should first revise the definition of "non-rural" carrier to exclude carriers such as RTC. Furthermore, it should modify the non-rural mechanism as described herein, or it should abandon the mechanism as unworkable, and rapidly move towards a new unitary support system for all carriers.

SureWest has demonstrated that it is inappropriate to include carriers such as RTC in the "non-rural" category, since RTC, with only 134,000 access lines and two wire centers, lacks the economies of scale and scope of BOCs, and also lacks the numerous wire centers that might allow the discrepancies between the proxy and real costs to average out. The Joint Board and the Rural Task Force have recognized these principles. The result of this improper classification of RTC is that although it is a high cost company whose subscribers pay rates significantly higher than the national average and significantly higher than those of the surrounding BOC, these subscribers, receive no federal support.

The record in this proceeding demonstrates that the proposal in the *RD* for states to certify that their rates are below a certain benchmark fails to remedy egregious intrastate rate disparities, as required by the Tenth Circuit's remand. One reason why this mechanism cannot succeed is that since the vast majority of states will not receive federal support under the *RD*, and they have no incentive to so certify.

Indeed, the record shows that the driving force behind the *RD* and its supporters appears to be the non-statutory goal of reducing the total amount of federal support. While SureWest recognizes that it is reasonable to avoid a truly "excessive" funding obligation, it is clear that the Joint Board and the supporters of the *RD* consider any growth to the current fund to be "excessive", and that this concern drives the "status quo" result of the *RD*, and the support for that status quo by proponents of the *RD*. Such motives are clear in the support of some parties for the use of the 135 percent benchmark, since that benchmark results in denial of funding to almost all of the states. SureWest asserts that the Board and such commenters have improperly shifted the focus of the task at hand from one of ensuring service to end users, to one of minimizing payments to the fund. This is inconsistent with the principles in Section 254(b).

The record also demonstrates that the proposals in the *RD* are based on the continuation of numerous implicit subsidies, contrary to the requirement of Section 254(e). One form of implicit subsidy at issue herein is state requirements that carriers have uniform rates throughout a state, the effect of which is that users in low-cost areas to subsidize or transfer support to users of high-cost lines within the State. The *RD* enhances and encourages this prohibited effect by recommending that federal support be based on state-wide averaged costs: since most states are served primarily by one non-rural carrier, the "state-wide" average cost is actually the average cost of that non-rural carrier to serve all subscribers in the state. As a result, subscribers to a "non-rural" company do not receive the support that they would if their company was "rural", and this provision of support to one set of high-cost subscribers but not to

another set of high-cost subscribers is an implicit subsidy of the former set of subscribers.

In remedying the RD, the Commission should alter its rules and policies to exclude RTC from the category of "non-rural" carriers, and treat RTC in a manner similar to other high-cost companies. Such action can and should be taken immediately. In addition, numerous other revisions to the "non-rural" mechanism are necessary. In order to incent states to reduce egregious intrastate discrepancies in local rates, the mechanism must be altered to provide support to more states. Furthermore, the Joint Board must establish a unified state/federal policy for rate comparability occurring within each state. SureWest recommends that a factor of 120 percent or less be used for comparability of rates. This "Proper Zone of Reasonableness" ("PZOR") would provide the appropriate mechanism for a comparability factor for the local market area. Further, since universal service is an obligation that is shared between federal and state support mechanisms, a similar or higher rate comparison benchmark should be established by each state for that state's provision of its own universal service support. The difference between the state rate benchmark and the 120 percent national benchmark would be funded through federal universal service.

If the Commission and Joint Board are not willing to remedy the flaws in the current non-rural mechanism, then it should be abandoned and a new <u>unitary</u> system for all carriers should be created, rather than creating two new systems for rural and non-rural carriers, thus doubling the required work.

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## REPLY COMMENTS OF SUREWEST COMMUNICATIONS ON RECOMMENDED DECISION

SureWest Communications, by its attorney, hereby files its Reply Comments in response to the *Public Notice*, DA 02-2976, released November 5, 2002, seeking comments on the <u>Recommended Decision</u> issued by the Federal-State Joint Board on Universal Service on October 16, 2002 (FCC 02J-2, hereinafter "*RD*"). As discussed further below, there is substantial evidence in the record that the proposals in the *RD* are based on prohibited implicit subsidies, and are otherwise flawed policies. In addressing these flaws, the Commission should first revise the definition of "non-rural" carrier to exclude carriers such as RTC. Furthermore, it should modify the non-rural mechanism as described herein, or it should abandon the mechanism as unworkable, and rapidly move towards a new unitary support system for all carriers.

SureWest's wholly-owned subsidiary Roseville Telephone Company ("RTC") is an incumbent local exchange carrier ("ILEC").

### I. The Record Demonstrates that the Proposals In the RD are Contrary to Statute and Flawed Policy.

A. Comparability, Support for All High Cost Areas, and Use of State-Wide Averaging

In its initial Comments, SureWest demonstrated that the *RD* failed to fulfill the requirements of Section 254(b)(3) to ensure that consumers "in rural, insular and high cost areas, should have access to [telecommunications services] that are reasonably comparable to those provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas." Specifically, SureWest noted that the *RD* failed to fulfill the comparability requirement in two ways:

- 1. As demonstrated in the Separate Statements of Commissioner Martin and Commissioner Rowe, the *RD* proposes the comparison of state-wide averaged <u>costs</u> of providing service to determine eligibility for federal high-cost support, while the statute requires eligibility to be based on comparability of <u>rates</u>.
- 2. The *RD*'s proposed "supplemental" rate-based analysis to be performed by each state as part of a certification fails to actually <u>compare</u> rates. The mere fact that all rates in a state are under some set benchmark does not, as a matter of logic or fact, mean that all of the rates under that benchmark are comparable.

SureWest Comments at pages 6-7.

SureWest also showed that use of the Commission's forward-looking proxy model as the basis for determining high-cost support is a deeply flawed policy. The use of the proxy model is not appropriate for carriers, such as RTC, that lack the economies of scale and scope of BOCs, and is also inappropriate for carriers like RTC which have

only two wire centers, since there is little chance for discrepancies between the proxy and real costs to average out. The Joint Board and the Rural Task Force have recognized these principles. SureWest also noted that use of the forward looking costs as the basis for determining high-cost support is unwise because such "costs", as noted by Commissioner Martin, "have little, if any, nexus to the establishment of end-user retail rates ... [and result] in support being provided to some areas with low end user rates while certain areas that have high rates receive insufficient support." Separate Statement at page 5.<sup>2</sup> RTC's situation is a prime example of Commissioner Martin's critique: it has a high cost study area with resulting rates significantly higher than those of the surrounding SBC areas, but receives no federal high-cost support. Clearly this is not the intended result of a rational support policy. SureWest Comments at pages 10-

There is significant support in the record for the concerns expressed above by SureWest. SBC notes that "the *Recommended Decision* does nothing to establish a link between the support that is being provided and the rates that are being charged in rural and high-cost areas." Comments of SBC Communications Inc. at page 5. The Montana Public Service Commission states that the "Joint Board has not defined when costs in high-cost areas are reasonably comparable to costs in low-cost urban areas.... [and that as] a result, the Recommended Decision leaves intact nearly all the infirmities

<sup>&</sup>lt;sup>2</sup> Commissioner Rowe similarly questioned "the accuracy of the model." Separate Statement at page 13.

that the Court identified within the Ninth Order."<sup>3</sup> The Maine Public Service

Commission states that "the Joint Board's recommended decision clarifies nothing
about the specifics of cost-based support as required by the Court." Comments of

Maine PSC at page 7.

#### B. Use of the 135% Benchmark is Flawed.

In its initial Comments, SureWest noted that even if one were to accept the proposal to use state-wide averaged costs, the use of the 135% benchmark is a flawed policy. In response to the Court's remand, the *RD* added reliance on a GAO Study, "cluster analysis" and use of standard deviation statistical techniques to justify and reaffirm the 135 percent figure. Commissioner Rowe ably demonstrates the flaws in each of these attempted justifications. Separate Statement at pages 2-9. But the bottom line on the effect of using the 135 percent figure is that federal funding is denied to almost all states. As Commissioner Rowe points out, nothing in the legislative history of the 1996 Telecommunications Act suggests that Congress intended universal service support to be available only to carriers or states in the top three percentiles of cost as reflected in the results of the standard deviation analysis. Separate Statement at page 7. Again, there was substantial criticism of the 135 percent benchmark, and the new justifications of that figure, in the Comments. See Comments of Maine PSC at pages

<sup>&</sup>lt;sup>3</sup> Comments of Montana Public Service Commission, Montana Consumer Counsel, Vermont Public Service Board, and Vermont Department of Public Service (hereinafter "Montana PSC") at page 5.

13, 15; Comments of Montana PSC at pages 7-25; Comments of Qwest Communications International Inc. at pages 2, 4, 10-14.<sup>4</sup>

C. The State Certification Proposal Fails to Remedy Egregious Intrastate Rate Discrepancies.

As discussed in pages 15-16 of its Comments, SureWest is particularly concerned that the proposals in the *RD* fail to constitute a remedy to egregious intrastate rate discrepancies. RTC is surrounded by SBC, so the comparable local rates for consumers will invariably be those of SBC. As shown in the SureWest Comments, due to differences in rate averaging and economies of scale, RTC's residential local rates are 185 percent, and its business rates are 239 percent, of those of SBC in the surrounding areas.<sup>5</sup> This results in large part because SBC rates are averaged state-wide through very dense population centers, and then applied to the high cost areas of Northern California where both SBC and RTC provide service.

Concern over discrepancies in intrastate rates was not expressed by SureWest alone. Qwest points out that while the Tenth Circuit required the Commission to create a method that induces states to address intrastate rate discrepancies, the requirement

In its initial Comments, SureWest demonstrated that basing eligibility on state-wide <u>costs</u> is contrary to statute and good policy, and thus it recommended the establishment eligibility by comparing <u>rates</u> within each state. RTC recommended a factor of 120 percent or less be used for comparability of rates. While parties such as Qwest and Maine PSC critique the total approach in the *RD*, they note that if a state-wide cost benchmark is to be adopted, the figure used for comparison should be significantly reduced. *See, e.g.,* Comments of Qwest at page 7 (107-117 percent) and Comments of Maine PSC at page 23 (125 percent). These figures are comparable to the 120 percent rate figure suggested by SureWest.

Disparities among local rates of nearby carriers are noticed by consumers. In a third party study conducted for SureWest by JD Franz Research, Inc., 86% of the business and 85% of the residential customers surveyed were concerned about the differential between RTC's rates and those of the carrier in surrounding communities.

for states to certify to comparability cannot do so, since the vast majority of states will not receive federal support under the *RD*, and thus have no incentive to so certify. Comments of Qwest at pages 8-9. Similarly, Montana PSC notes that "a supplemental support mechanism based on rates cannot cure defects in a cost-based support program that provides insufficient support. Comments at page 29. SBC notes that the "*Recommended Decision* does nothing to ensure that states have established the necessary explicit mechanisms for preserving and advancing universal service ...." Comments at page 18.

D. The Driving Force Behind the RD and its Supporters
 Appears to be the Non-Statutory Goal
 of Reducing the Total Amount of Federal Support.

While the *RD* recognizes the requirement under Section 254 to provide funding sufficient to ensure comparable and affordable rates, the Joint Board is particularly cautious about adopting funding procedures that would expand the total amount of federal funding so as to create an "excessively" large federal obligation. *See RD* at paras. 14 and 16. While SureWest agrees that it is reasonable to avoid a truly "excessive" funding obligation, it is clear that the Board and the supporters of the *RD* consider any growth to the current fund to be "excessive", and that this concern drives the "status quo" result of the *RD*, and the support for that status quo by proponents of the *RD*. *See*, *e.g.*, Comments of California Public Utilities Commission at page 9 (lowering the 135% benchmark would "significantly inflate the size of the federal fund, resulting in states like California subsidizing subscribers in other states); Comments of NASUCA at page 16 ("adoption of a 135% rate benchmark will not place additional immediate pressure on the size of the federal universal service fund…"); Comments of

Sprint Corporation at page 8 ("...the FCC must consider the size of the federal fund, which is already sufficient."). AT&T Corp. is at least direct in its assertion of this point, arguing that due to lack of an explicit command to expand the fund in Section 254, and the fact that the principles in Sections 254(b) are not commands, the FCC lacks the authority to take actions that would expand the size of the federal fund, and/or that it need not do so under Section 254. Comments at pages 7-13.

SureWest asserts that the Board and commenters such as those above have improperly shifted the focus of the task at hand from one of ensuring service to end users, to one of minimizing payments to the fund. Yet, of the six principles listed in Section 254(b), five are clearly intended to promote service to end users, and one discusses contributions by carriers. That solitary principle, Section 254(b)(4), requires that service providers make "equitable and nondiscriminatory" contributions, not that they make the smallest contribution possible. As the Montana PSC notes, the Joint Board's definition of sufficiency " ...curiously ... would have the effect of limiting the overall size of the universal service fund. This is a goal that the Joint Board has repeatedly pursued, but that is not in the list of statutory principles in section 254(b)." Comments at page 5.6

SureWest's goal in this proceeding is for end-users to have comparable and affordable local rates, and it urges the Commission to be mindful of evaluating policies from the perspective of the needs of end users. A good example of such an approach

See also, Id. at page 26, where the Montana PSC states that the "Joint Board's discussion [of urban benchmarks] is quite transparent in disclosing that the true motive was to avoid increasing the total amount of [federal] support."

is the analysis of comparability by the Maine PSC (Comments at page 25) based on consumer behavior: two rates are not comparable if an end user would consider the price difference materially different. Such an approach differs significantly from the improper approach that a number of other commenters took: comparability as the numerical function that would increase the burden on contributors the least.

## II. The Record Demonstrates That The Proposals in the *RD*Are Based on Prohibited Implicit Subsidies.

In addition to the flaws discussed above, the record demonstrates that the proposals in the *RD* are based on the continuation of numerous implicit subsidies. However, such an approach contradicts the requirement in Section 254(e) of the Act that federal universal service support mechanisms be explicit.<sup>7</sup> Accordingly, the proposals in the *RD* must be substantially altered or replaced.

One form of implicit subsidy at issue herein is state requirements that carriers have uniform rates throughout a state. The *RD* recognizes (at para. 24) that the effect of this approach is for users in low-cost areas to subsidize or transfer support to users of high-cost lines within the State. Yet the *RD* not only blithely accepts this situation, it enhances and encourages it by recommending that federal support be based on state-wide averaged costs: since most states are served primarily by one non-rural carrier, the "state-wide" average cost is actually the average cost of that non-rural carrier to serve all subscribers in the state. As SBC points out, while the Board admits that such an approach "may not be appropriate" for support to rural carriers, there is no basis in

<sup>&</sup>lt;sup>7</sup> See also Section 254(b)(5) of the Act which requires that federal universal service support mechanisms be specific.

the Act for relying on prohibited implicit subsidies for non-rural carriers either. SBC Comments at page 14, *citing RD* at para. 11. Furthermore, as discussed by Qwest (Comments at pages 7-8), reliance on these implicit subsidy is unsustainable in the face of growing competition. Yet, the states have little incentive to eliminate such implicit subsidies from state rate-making policies unless forced to do so by the FCC. Indeed, even CLECs support the elimination of such implicit subsidies. *See* Comments of Competitive Universal Service Coalition at pages 10-12.

A second form of implicit subsidy at issue in this proceeding results from the flawed use of different support mechanisms for "rural" and "non-rural" carriers.

Subscribers exist in certain high-cost areas who take service from a company that would receive federal support if it were classified as "rural", but in fact receive no federal support because it is classified as "non-rural". As a result, that company receives no federal support, and the company's subscribers must pay higher rates. This provision of support to one set of high-cost subscribers, but not to another set of high-cost subscribers is an implicit subsidy of the former set of subscribers. Such a result is not only inconsistent with the statutory requirement for explicit support mechanisms, it is inconsistent with the purposes of federal support. As SBC notes (Comments at page 14), "[t]he purpose of the universal service mechanism is to provide support that is

The difference between the two support systems also leads to a form of regulatory gaming or arbitrage, in which carriers alter the size of their study areas, or other operational characteristics, in order to qualify as "rural" rather than "non-rural" carriers. See Comments of SureWest at note 6.

sufficient to maintain affordable prices in rural and high-cost areas, not to allocate support differently based on arbitrary categories of carriers."

## III. The "Non-Rural" Mechanism Must be Revised or a Unified Mechanism for All Carriers Should be Enacted Rapidly.

As shown in numerous Comments, the proposals in the *RD* are in many ways inconsistent with the requirements of Section 254 of the Communications Act and are not responsive to the remand from the Tenth Circuit. In addition to flaws within the proposed non-rural support mechanisms, the *RD* fails to appropriately address the needs of mid-sized ILECs such as RTC, which have been classified as "non-rural" for purposes of federal high-cost support, but which in fact are exponentially smaller than the huge BOCs with which they are included. Subscribers in Roseville, California should not have federal support denied to them because of the arbitrary and improper classification of RTC as a carrier equivalent to a BOC. Rather, the Commission should alter its rules and policies to exclude RTC from the category of "non-rural" carriers, and treat RTC in a manner similar to other high-cost companies. Such action can and should be taken immediately.

Subsequent and in addition to altering the categorical definition of "non-rural" companies, numerous other revisions to the "non-rural" mechanism are necessary. In order to incent states to reduce egregious intrastate discrepancies in local rates, the mechanism must be altered to provide support to more states. Furthermore, the Joint Board must establish a unified state/federal policy for <u>rate</u> comparability occurring within each state. SureWest recommends that a factor of 120 percent or less be used for comparability of rates. This "Proper Zone of Reasonableness" ("PZOR") would provide the appropriate mechanism for a comparability factor for the local market area. Further,

since universal service is an obligation that is shared between federal and state support mechanisms, a similar or higher rate comparison benchmark should be established by each state for that state's provision of its own universal service support. The difference between the state rate benchmark and the 120 percent national benchmark would be funded through federal universal service.

If the Commission and Joint Board are not willing to remedy the flaws in the current non-rural mechanism, then it should be abandoned and a new mechanism created. Indeed, it may be the case that the current federal support system can no longer be repaired though a patchwork of cumbersome and sometimes unlawful fixes that perpetuate the current problems. In that case, the Commission and Board should rapidly commence work on a unitary system for all carriers, rather than creating two new systems for rural and non-rural carriers, thus doubling the required work. Furthermore, working on a unitary system would allow the Commission and the Board to avoid repeating the mistakes of the past that led to the prohibited implicit subsidies resulting from differences between the rural and non-rural support mechanisms. The new support system should concentrate on future network configuration, and ensure that the costs of federal support to ensure comparable and affordable rates are equitably shared by the entire communications industry.

As shown in note 3 of the Comments of the Competitive Universal Service Coalition, the proposal to address and revise the rural support mechanism at some time in the future left the Tenth Circuit unable to evaluate whether the total level of federal support for all carriers meets the statutory "sufficiency" requirement. <a href="Qwest Corp. v. FCC">Qwest Corp. v. FCC</a>, 258 F.3d at 1204-05. Until the Commission addresses revised support for such carriers, this lack of regulatory certainty will hang over the current system.

SureWest notes that AT&T also calls for the Commission to begin working on a unitary support system. Comments at pages 18-21. However, it is clear that AT&T's motive for seeking a unitary system is reducing payments by carrier contributors, rather than promoting the goals of Section 254 to advance and preserve universal service.

IV. Conclusion

The record demonstrates that the proposals in the *RD* do not fulfill the mandate

in Section 254 of the Act to ensure that subscribers in high-cost areas receive service at

rates reasonably comparable to those in other areas. The record also demonstrates

that the use of state-wide average costs and the 135 percent benchmark are flawed

policies that do not yield the results intended by the Act, and that the state certification

procedure fails to address the Tenth Circuit's mandate to induce states to remedy

egregious discrepancies in intrastate rates. Lastly, the RD fails to appropriately

address the needs of mid-sized ILECs which have been classified as "non-rural" for

purposes of federal high-cost support, but which in fact are exponentially smaller than

the huge BOCs with which they are included. In addressing these flaws, the

Commission should first revise the definition of "non-rural" carrier to exclude carriers

such as RTC. Furthermore, it should modify the non-rural mechanism as described

herein, or should abandon it as unworkable, and rapidly move towards a new unitary

support system.

Respectfully submitted,

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### **CERTIFICATE OF SERVICE**

I, Joan P. George, a secretary in the law firm of Fletcher, Heald & Hildreth, do hereby certify that a true copy of the foregoing *Reply Comments of Surewest*Communications on Recommended Decision was sent this 17<sup>th</sup> day of January, 2003, via hand where indicated and via United States First Class Mail, postage prepaid, to the following:

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